FITCH AFFIRMS VIRGIN ISLANDS WAPA'S SR. AND SUB LIEN BONDS AT 'CCC'

Fitch Ratings-New York-15 June 2018: Fitch Ratings has affirmed the 'CCC' ratings on the following U.S. Virgin Islands (USVI) Water and Power Authority (WAPA) revenue bonds:

--$118,850,000 electric system revenue bonds, series 2012A, 2010A, 2010B, 2010C, 2003;
--$96,800,000 electric system subordinated revenue bonds, series 2007A, 2012B, 2012C.

Fitch has removed the ratings from Negative Watch.

SECURITY

The electric system revenue bonds are secured by a pledge of net electric revenues and certain other funds established under the bond resolution. The electric system subordinated revenue bonds are secured by a pledge of net revenues that are subordinate to the pledge securing the electric system revenue bonds. A default on the subordinate lien bonds does not trigger a cross default on the senior lien revenue bonds.

Outstanding senior and subordinate lien bonds are also secured by fully funded debt service reserve funds, which management reports have a combined balance of $17.6 million.

KEY RATING DRIVERS

ELEVATED DEFAULT RISK: The 'CCC' rating reflects heightened default risk as a consequence of WAPA's exceptionally weak cash flow and liquidity, consistently low unrestricted cash reserves, history of exceptionally high government receivables and nearly depleted borrowing capacity under its lines of credit.

LIQUIDITY CHALLENGES REMAIN: Removing the Rating Watch Negative reflects the abatement of the immediate risk of default, as management reports that July debt service will be paid in full and that debt service reserve funds remain fully funded. The 'CCC' rating reflects the longer term risk associated with the continuation of poor financial performance and WAPA's stress related to an outstanding $24.5 million legal judgement.

CHALLENGED SERVICE TERRITORY: WAPA serves a geographically and economically challenged territory that is largely dependent on tourism and government employment. USVI's narrow economy with low per capita income is compounded by its exceptionally high electric rates and high of level of USVI government receivables. These concerns are further heightened following two category-five hurricanes that hit the USVI in September 2017.

FEDERAL FUNDING SUCCESS: WAPA is participating in various federal grant and loan programs in the aftermath of the hurricanes. Proceeds will be used to repair/rehabilitate the system, which should bolster WAPA's CIP and add system protections against future storms. Through FEMA, HUD and other federal programs, over $1 billion in grants have been approved for WAPA.

RATING SENSITIVITIES

EVIDENCE OF RESTRUCTURING OR DEFAULT: Evidence that a restructuring of, or default on, outstanding debt of the U.S. Virgin Islands Water and Power Authority (WAPA) is probable, including the passage of enabling legislation or an inability to meet near-term liquidity demands, would result in further negative rating action.

NEGOTIATED RESOLUTION TO LIQUIDITY CHALLENGES: Any negotiated resolution to the near term liquidity challenges facing WAPA, including long-term rate relief, reinstatement of bank borrowing capacity or repayment of overdue governmental receivables would be evaluated for commercial reasonableness and sustainability. At March 31, 2018, available liquidity was only about $8.8 million.

FISCAL 2017 AUDIT AVAILABILITY: The fiscal 2017 (FYE 6/30) audit is not yet available. Should results prove substantially different than currently anticipated, there may be rating movement. The effect of the storms and associated federal grants will be reflected in fiscal 2018, and year to date results are not available. The receipt of federal funds may serve to improve WAPA's infrastructure and extremely weak financial position, leading to positive rating action.

CREDIT PROFILE

WAPA is the sole provider of electric and water service to the USVI (St. Thomas, St. Croix and St. John). The electric system generates, transmits and sells electric power and energy to currently more than 53,629 residential, commercial and large power customers, including the government. In 2016, before the impact of two category five hurricanes that hit the island nation, there were an estimated 55,000 customers.

WAPA also owns and operates a water utility system. There are separate financial statements for each of the utilities and debt is separately secured. However, the two systems share common administrative and operating personnel. Additionally, a portion of each system's operating expenses is paid initially by the electric system, which also bills the water system for its share of such expenses. The electric system and water system also share dual-purpose plants for the production of electricity and water.

System Impacts from the Hurricanes

The U.S. Virgin Islands felt the brunt of two major hurricanes in September 2017 (fiscal 2018). WAPA's transmission and distribution system sustained significant damage. Two of its power plants, one in St. Croix and the other on St. Thomas, were also damaged. WAPA estimated that 80% of the transmission and distribution system on St. Thomas was damaged; 60% damage to St. Croix's infrastructure, while St. John was even further impacted, with the damage affecting 90% of their electrical infrastructure. It was also reported that two outer islands, Hassel and Water, also saw electrical infrastructure damage.

Following the storms, WAPA began making repairs to restore service and at the same time developed a mitigation plan for the enhancement of the overall resiliency of the generation and distribution systems to minimize the impact of future storms.

The mitigation plan includes the replacement of traditional wooden poles with composite poles on key transmission feeders. It is reported that these poles have the ability to withstand sustained wind speeds of up to 200 miles per hour. The plan also includes undergrounding key facilities. Prior to the hurricanes, the facilities for critical infrastructure (hospitals, airports and 75% of the business districts) were already underground and therefore were the first facilities restored.

As of March 19, 2018, 100% of power had been restored, representing more than 53,629 customers, based on those who are able to receive power. In addition, all underground facilities and critical loads have been restored, and the LED street light system has been energized. Management reports that about 1,300 customer accounts have been closed following the hurricanes and it has not yet been determined whether these closures are permanent.

Financial Impact from the Storms

During the period immediately following the storm (September 2017 through December 2017), monthly customer payments averaged $2.5 million, compared with average historical monthly collections of approximately $16 million. WAPA has utilized FEMA Community Disaster Loans (CDL) to provide working capital to cover key operating expenses during this period. Management reports that restoration costs are being covered by FEMA 100%.

Historically, WAPA has maintained a large accounts receivable position with the Virgin Islands (VI) government. Given the devastating impact of the storms on VI, this receivable position hasn't diminished. As of March 31, 2018, the government of VI owed WAPA approximately $31.4 million for electric services. However, WAPA noted that VI has made periodic payments and that processes are now in place to ensure better collections. Fitch will monitor the results of these changes going forward.

Further, in focusing on restoration, WAPA did not bill customers from Sept. 5, 2017 through Dec. 17, 2017, and resumed billing on Dec. 18, 2017 for services provided prior to the hurricanes. Bills for new service began in February 2018 covering the period from the customer's power restoration date to the actual date of the meter reading. The smart meter system was damaged in the storms, therefore meter reading has been done manually. It is expected that the smart meter system will be up and running this summer. Customer late fees have been waived to encourage repayment of outstanding obligations and a payment plan will be offered.

Management reports that the economic impact of the storms will continue as the tourism industry rebuilds, consumer spending rebounds and larger hotels and commercial customers reopen. Given this is now the "off season", tourism will remain low at least over the next few months.

Federal Funds to Bolster Financial Position

In the aftermath of the hurricanes, WAPA is or will be the recipient of federal grant programs, including FEMA's Public Assistance Grant Program, FEMA's Hazard Mitigation Grant Program, additional FEMA grant funding authorization, and HUD. These funds have been or will be used to repair, replace and renew components of the system. Favorably, some of the federal funding is being used to aid in strengthening the system in order to help mitigate the effects of future storms. To date, these federal funds have totaled approximately $1.2 billion.

In addition to these federal grants, WAPA is eligible to participate in the CDL program. These proceeds cannot be used for debt service, but are available for operations and essential services -- a form of liquidity.

Liquidity Remains Slim

WAPA has historically operated with low liquidity and poor cash flow, due in part to delays in implementing necessary rate increases and elevated accounts receivables largely attributable to government payors. This trend continues and preliminarily, fiscal 2017 results show total receivables of $48.6 million, of which $29.6 million is due from the public sector.

Cash flow in fiscal 2018 was hampered following the storms, but management advised that WAPA was able to use excess funds in the debt service reserve fund, make special arrangements with vendors, use revenues associated with fuel hedges, and the proceeds of the CDL to manage its position.

WAPA provided Fitch with its interim position (March 31, 2018), which shows very slim, though slightly improved liquidity over the June 30, 2017 level of about $4.9 million. At March 31, 2018, there was available liquidity of approximately $8.8 million, including cash and overdraft on its LOC. Management reports it is negotiating with its liquidity facility providers as the agreements near expiration.

While liquidity has been week, debt service coverage, as reported in WAPA's 2016 audit, has been acceptable. The 2016 audit reports 2.07x coverage of senior lien bonds, 1.31x senior and subordinated lien bonds, and 1.12x coverage of all debt. Fitch calculated all-in coverage showed a much weaker 0.73x. Preliminarily, management reports strengthening in 2017, with senior coverage at 2.83x, 1.80x senior and subordinate and 1.56x all debt.

Further, management reports that debt service payments have been made, that the July 2018 payment will be made, and that there has not been a draw on the debt service reserve funds to support debt service.

Capital Financing Plans

WAPA's forthcoming financing plans are largely refundings/restructurings for debt service savings, with additional debt expected to range between $40 million and $93 million. The new debt will include another CDL loan to fund working capital to pay core operating expenses (allowed usage of CDL) and another issuance to finance three energy efficient generating units that will replace old, less efficient units.

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Applicable Criteria
Rating Criteria for Public-Sector, Revenue-Supported Debt (pub. 26 Feb 2018)

https://www.fitchratings.com/site/re/10020113
U.S. Public Power Rating Criteria (pub. 18 May 2015)
https://www.fitchratings.com/site/re/864007